United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

76-7435

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ORIGINAL

APPEAL DOCKET NO. 76-7435

WARNER-JENKINSON COMPANY,
Plaintiff-Appellant,

against

ALLIED CHEMICAL CORPORATION,
Defendant-Appellee,

and

H. KOHNSTAMM & COMPANY, INC.,
Plaintiff-Intervenor-Appellant,

against

ALLIED CHEMICAL CORPORATION,
Defendant-Appellee.

Appeal from an Order and Judgment of the United States District Court for the Southern District of New York

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

Dated: December 6, 1976
At: New York, New York

UNITED STATES COURT OF APPEALS
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SECOND CIRCUIT

KENYON & KENYON REILLY CARR & CHAPIN
Francis T. Carr
Paul Lempel
Edwin Baranowski
Philip J. McCabe
Stephen B. Shear
59 Maiden Lane
New York, New York 10038
(212) 425-7200
Attorneys for Appellants
Warner-Jenkinson Company and
H. Kohnstamm & Company, Inc.

OF COUNSEL

Donald G. Leavitt
Koenig, Senniger, Powers & Leavitt
611 Olive Street
St. Louis, Missouri 63101
(314) 231-0109
Counsel for Warner-Jenkinson Company

Patrick J. Joyce
1270 Avenue of the Americas
Suite 2102
New York, New York 10020
(212) 247-5810
Counsel for H. Kohnstamm & Company, Inc.

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REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

This Reply Brief is directed to new contentions raised in Allied's Brief (hereinafter "Allied Br.").

I. The Prior Settlement Does Not Bar This Action

The 1975 Stipulation and Order, which dismissed Warner-Jenkinson and Kohnstamm's declaratory judgment patent claims without prejudice, alluded to the fact that the parties had settled the case but made no reference to the Settlement Agreement, the License Agreements, or the terms of those Agreements. [A-69-70] None of the Agreements was "So Ordered" by Judge Conner.* [A-72; A-76; A-89]

The Settlement Agreement provided that Warner-Jenkinson and Kohnstamm shall pay $200,000 to Allied, whereupon they and their suppliers and vendees shall be released from all past infringement liability. [A-73] That liquidated amount was paid to Allied on September 10, 1975.

In addition, the Agreement called for the parties to

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* Judge Conner was initially involved in those portions of the settlement discussions which resulted in the parties' agreeing in principle to the payment of a specific sum of money to Allied for past activities and the granting of manufacturing licenses to Warner-Jenkinson and Kohnstamm at a 17-1/2% royalty rate. Once these matters were agreed upon in principle, the details were worked out by the parties over a period of about 4 months during which time Judge Conner was consulted only on matters concerning royalties on goods sold after March 1, 1975; royalties during the period of third-party infringement and third-party settlements; and foreign patent rights. There is no evidence that Judge Conner ever considered the non-termination clauses or the nature of the dismissal. [A-41] The docket sheets for 72 Civ. 301 (Consolidated) do not indicate that the Settlement Agreement or License Agreements were ever filed.

enter into License Agreements and also for dismissal without prejudice of the patent claims. [A-73-74]

Allied has cited no case other than Aro Corp. v. Allied Witan Co., 531 F.2d 1368 (6th Cir. 1976), and Warner-Jenkinson and Kohnstamm are aware of no case, in which a license agreement, entered into pursuant to a private settlement agreement which also provided for dismissal of a patent action without prejudice, has been held a bar to litigation.* However, even the Aro decision prescribed a balancing of interests on a case-by-case basis and cannot be deemed to support the general proposition that all license agreements negotiated in combination with a dismissal without prejudice are summarily to be accorded res judicata effect.

In Aro, the settlement agreement provided for a license agreement at nominal terms in return for:

> inter alia, dismissal of the [infringement] suit, release for past infringement of [the licensee], its suppliers and customers, and forgiveness of certain costs awarded against [the licensee] by the District Court.... [531 F.2d 1368,1372]

After entering into the settlement and following dismissal of the action, the licensee refused to make any royalty payments under the license agreement. [Id. at 1370] Thus the

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* Compare, Rialto Products, Inc. v. Rayex Corp., 166 U.S.P.Q. 222 (N.Y. Sup. Ct. 1970) wherein a stipulation of dismissal without prejudice and settlement agreement acknowledging patent validity were not a bar to a later challenge to patent validity.

patentee received nothing in exchange for the settlement. Accordingly, the Aro Court was moved by both the inequities flowing from the licensee's conduct and the failure of consideration.

Here, however, there is no question concerning Warner-Jenkinson and Kohnstamm's payment of $200,000 to Allied for past activities. Allied has thus received its bargained-for consideration for the Settlement Agreement.

Allied apparently believes that application of the Aro balancing of interests test would preclude a challenge to patent validity in this case because the non-termination clauses in the License Agreements last for 2 years whereas the patent in suit in Aro would not expire for 3-1/2 years. [Allied Br. at 45 (footnote)] This comparison is not apt since the effect on the public lies in the patents' expiration dates. Allied does not contest the fact that royalties payable would be substantial (instead of the nominal royalties payable in Aro) and that there is no unpatented alternative to F.D. & C. Red No. 40 (a fact not shown in Aro). Thus, Allied's patents, which will not expire for more than 10 years, constitute a significant economic burden on the public which will ultimately pay the large royalties exacted by Allied from its licensees.

Further, in Aro the fact of the 3-1/2 years remaining in term of the patent was used to justify the decision not to permit any challenge to patent validity. In the instant suit it is undisputed that the patents' validity could be litigated following expiration of the 2-year non-termination period. [A-295, 298]

Accordingly, no economy of judicial resources would be achieved if Allied is permitted to postpone this challenge to validity.

The other cases which Allied cites in support of summarily interpreting and enforcing the instant License Agreements are inapposite. In Ransburg Electro-Coating Corp. v. Spiller & Spiller, Inc., 489 F.2d 974 (7th Cir. 1973) the agreement settling a patent infringement suit provided for (1) payment based upon past activities, and (2) a license for future use. When the accused infringer subsequently failed to make timely payments of a portion of the sum owed for past infringement, the patentee brought a diversity action to compel payment of the monies due. In its opinion, the Court of Appeals for the Seventh Circuit carefully noted that the agreement was a settlement to pay damages for past injuries, and that accordingly Lear, Inc. v. Adkins, 395 U.S. 653 (1969) did not permit the accused infringers to repudiate the settlement. [489 F.2d at 976-78] In making this distinction the Ransburg Court observed that it was erroneous to equate settlement for past infringement with a license for prospective use requiring the payment of continuing royalties. [489 F.2d at 977]

In the instant litigation Warner-Jenkinson and Kohnstamm, as part of the 1975 Settlement Agreement, obligated themselves to pay Allied $200,000 for past activities. As stated above, that sum was timely paid. [A-38, 41] Accordingly there is no issue presently involved in this litigation to which the rationale of the Ransburg opinion is applicable.

Meetings & Expositions, Inc. v. Tandy Corp., 490 F.2d 714 (2d Cir. 1974) (hereinafter cited as Tandy) was a diversity action involving a breach of contract claim. The parties in that action worked out a settlement agreement which was "So Ordered" by the district court. [490 F.2d at 716 n.1] Before the case was dismissed with prejudice pursuant to the settlement agreement, the defendant breached the settlement agreement and obtained a dismissal for want of personal jurisdiction. On appeal the Court of Appeals for the Second Circuit found that entering into a settlement agreement that was "So Ordered" by a judge was a submission to the personal jurisdiction of the court. Further, the Court held that the district court had "the duty to enforce a settlement agreement which it has approved." [490 F.2d at 717 (emphasis added)]

The Tandy opinion highlights the significance of a "So Ordered" settlement agreement and vividly illustrates the deficiency in Allied's position. Allied clearly wishes that it had been able to secure the consent decree which it initially sought. Ignoring the fact that it negotiated away a consent decree on the patent issues and accepted a dismissal without prejudice, Allied argues that the Stipulation and Order of dismissal without prejudice somehow converted the Settlement Agreement and the License

Agreements into Court-approved documents.* Allied, however, should not be permitted to recapture here what it surrendered at the bargaining table.

Allied seeks to treat the Licenses as judicial decrees and the non-termination clauses therein as judicial bars to a challenge to the validity of the licensed patents by implying that Judge Conner "approved" the "bargain" between the parties. [Allied Br. at 6] Allied states that the Settlement Agreement was "endorsed" by Judge Conner, [Allied Br. at 27-28] and that he certainly had in mind all of the settlement papers when he signed the Stipulation and Order of dismissal. [Allied Br. at 6, 44] From these unsubstantiated assertions, Allied concludes that the dismissal without prejudice was "on the condition embodied in the underlying Settlement and License Agreements (A-72; A-76; A-89) that royalties be paid for a minimum of two years and that litigation would not be renewed by Warner-Jenkinson and Kohnstamm during that time." [Allied Br. at 15]

To support the argument that Judge Conner approved the Settlement and License Agreements for the purpose of preventing litigation on the validity of Allied's patents for two years, Allied relies on Judge Conner's "awareness" of the Agreements and

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* For a general discussion of the effect of consent decrees vis-a-vis stipulated dismissals and settlement agreements see Note, "To Bind or Not to Bind": Bar and Merger Treatment of Consent Decrees in Patent Infringement Litigation, 74 Colum. L. Rev. 1322, 1325-26 (1974). This note was cited in Wallace Clark & Co., v. Acheson Indus., Inc., 532 F.2d 846,849 n.5 (2d Cir. 1976).

an opinion expressed in an affidavit of Allied's counsel (Mr. Gilbreth)* that the non-termination clauses were intended to bar a challenge to patent validity for two years. [Allied Br. at 15-16]

At the hearing of August 11, 1976, counsel for Warner-Jenkinson and Kohnstamm countered the opinion of Allied's counsel and advised the Court of his view that the non-termination clauses had nothing to do with a prohibition against challenging validity:

> MR. CARR [Counsel for WARNER-JENKINSON and KOHNSTAMM] Your Honor, the agreement talks of termination. It does not talk about litigation or the right to test validity. It talks only about termination. [A-295-96]

Further evidence that Warner-Jenkinson and Kohnstamm's purpose in signing the Settlement Agreement and License Agreements was to allow them to challenge the validity of the licensed patents is supplied by their refusal to accede to a consent decree and their insistence on a dismissal without prejudice of the patent claims. At the August 11th hearing, counsel for Warner-Jenkinson and Kohnstamm stressed this point by stating:

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* The Gilbreth Affidavit [A-42, ¶12] is inadequate support for the contention that the purpose of the two-year non-termination clauses was "to prevent plaintiffs from promptly reinstituting their actions." Since there is no intimation that the affiant was speaking from personal knowledge, this portion of his affidavit, even if relevant, is of no probative value. See Rule 56(e), Fed.R.Civ.P. The affiant was not a party to the agreements, therefore his knowledge respecting the parties' (or Judge Conner's) intentions must be based, at best, on hearsay. Accordingly, this portion of the affidavit can avail Allied nothing. See 6 Moore's Federal Practice ¶56.22[1] at 1312-13 and cases cited therein.

> MR CARR: There is only one thing in the agreement or settlement papers that speaks of that, not expressly. It says the dismissal shall be without prejudice. That language didn't get in there by accident.
>
> THE COURT: You mean to say that covered the "Red 2" situation?
>
> MR. CARR: It covered any situation in which we wanted to reinstitute [a challenge to the] validity of that patent. [A-295]

In effect, Allied is attempting to subvert the unequivocal meaning of a dismissal without prejudice by allegations concerning the purpose and motivation of the District Judge who signed the Stipulation and Order. Allied's theory would lead to the unacceptable result of destroying the plain meaning of the words "without prejudice" by permitting assertions that a dismissal without prejudice was not what its plain words mean but rather was intended to prevent a subsequent adjudication of issues involved in the dismissed case.

In addition, the theory espoused by Allied would necessitate an inquiry, by deposition or other discovery technique, into the purposes and motivations of the judge who signs an order or opinion. Such a procedure has no place in our system of jurisprudence.

II. The District Court Dismissed the Complaint Pursuant to the *Thiokol I** Doctrine and Not as an Exercise of Its Discretion

Allied contends that the District Court's decision

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* *Thiokol Chemical Corp. v. Burlington Indus., Inc.*, 313 F.Supp. 253 (D.Del. 1970), *aff'd*, 448 F.2d 1328 (3rd Cir. 1971), *cert. denied*, 404 U.S. 1019 (1972).

to dismiss the Complaint was an exercise of its discretion to decline jurisdiction [Allied Br. at 24] and that:

> The propriety or impropriety of the <u>Thiokol</u> doctrine is, we submit, not properly before the Court on this appeal. [Allied Br. at 38]

A review of the transcript of the August 11, 1976 hearing reveals the untenability of Allied's contention. Early in the hearing, Judge Frankel inquired about the existence and applicability of "the principle that declaratory relief is subject to equitable principles." [A-281] Counsel for Allied stated that there were two conditions precedent for declaratory judgment jurisdiction (justiciable controversy and federal question or diversity jurisdiction), and then declined to ask the Court to exercise its discretion. Instead Allied asked the Court to follow the <u>Thiokol</u> decision:

> MR. GILBRETH [Counsel for ALLIED]: However, there is an equitable principle that is found in some authorities for the proposition that even if the court satisfies itself that those two conditions precedent are met, it can, as a court of equity, decline to entertain the declaratory judgment action.
>
> If based on equitable considerations, it believes it should not entertain the action.
>
> There is limited authority for that proposition.
>
> THE COURT: You don't invoke that authority.
>
> MR. GILBRETH: We don't reach that question, your Honor. As a matter of fact, we researched those authorities and found

> that we didn't need them because of the particular circumstances of this case where we say they don't meet the conditions precedent. In particular and if your Honor wishes me to speak only to the question of justiciable controversy or actual controversy I am prepared to do that.
>
> It seems clear to us that the persuasive authorities and the authorities of this court are uniform for the proposition that a patent licensee cannot bring a declaratory judgment action against a patent licensor because there is no justiciable controversy with respect to the validity of the licensed patents.
>
> Just briefly stated, that proposition is found in the Thiokol decision. [A-281-82]

Thus Allied took the position that the "particular circumstances of this case" warranted the application of the *Thiokol I* doctrine. The District Court's acceptance of this position is evidenced by the Court's explicit adoption of "the *Thiokol* reason", *viz*., that a licensee must terminate before challenging patent validity, as the basis of its ruling. [A-292-93; Allied Br. at 38]

The "particular circumstances" relied upon by Allied to justify the District Court's decision are the two-year non-termination clauses in the Warner-Jenkinson and Kohnstamm License Agreements. These clauses [A-81,94] allegedly prohibit termination of the Agreements before March of 1977, thereby preventing Allied from charging infringement. The hearing transcript reveals that the District Court applied the *Thiokol I* doctrine in rendering its decision that these clauses precluded the existence of a justiciable controversy because Allied *could not* charge

Warner-Jenkinson or Kohnstamm with infringement.* **[See also, Allied Br. at 18] After a discussion of when the Licenses could be terminated [A-285-86], Judge Frankel concluded:**

> **THE COURT:** Next March if you want to terminate, your settlement is without prejudice to your right to attack one or both of these patents or their right to an attempt to enforce them. [A-295 (emphasis added)]
>
> ....
>
> All right, I think I am going to dismiss this on my understanding that if you choose to, you can bring it on around next March or thereabouts.... [A-298 (emphasis added)]

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* A case of actual controversy exists between Warner-Jenkinson and Kohnstamm, and Allied because:

1. The past dealings of the parties create a reasonable apprehension in Warner-Jenkinson and Kohnstamm that they will be sued by Allied for patent infringement in the event they stop paying royalties. [A-4-13] This is confirmed by statements of Allied's counsel [A-286] and intimations in Allied's Brief [Allied Br. at 47,54] that infringement suits will be brought if royalty payments are discontinued.

2. Prior to the instant litigation Warner-Jenkinson met with Allied and failed in negotiations concerning its license and Allied's alleged patent rights, thereby adding to the reasonable apprehension felt by Warner-Jenkinson and Kohnstamm. [A-322]

3. Controversy exists over whether royalties are payable by Warner-Jenkinson and Kohnstamm under Allied's invalid and unenforceable patents. [A-4-13]

4. Controversy exists between patent licensees and licensors. [Milton Roy Co. v. Bausch & Lomb, Inc., 418 F.Supp. 975,978-79 (D.Del. 1976)]

However, the authorities discussed in Warner-Jenkinson and Kohnstamm's main Brief (at 9-21) demonstrate that the right of a patent licensee to challenge the validity of a licensed patent does not depend upon termination of the patent license.

Notwithstanding Allied's attempted avoidance of the Thiokol I issue it nonetheless attempts to revive the Thiokol I doctrine by seeking to distinguish American Sterilizer Co. v. Sybron Corp., 526 F.2d 542 (3d Cir. 1975) and Medtronic, Inc. v. American Optical Corp., 327 F.Supp. 1327 (D.Minn. 1971) on the ground that diversity jurisdiction apparently existed in those cases. [Allied Br. at 41-42] However the District Court in the present case never reached the issues of diversity or federal question jurisdiction. [A-289-91]

Allied's argument that Judge Wright's decision in Milton Roy Co. v. Bausch & Lomb, Inc., 418 F.Supp. 975 (D.Del. 1976), "mis-applied" the American Sterilizer case [Allied Br. at 43] is undercut by another district court decision in the Third Circuit. Aluminum Co. of America v. Amerola Products Corp., 408 F.Supp. 1352,1353 n.1 (W.D.Pa. 1976) states that:

> [A] patent licensee can challenge the scope and validity of the underlying patent without first terminating its license agreement. [citing American Sterilizer].

Since the District Court did not exercise its discretion but instead relied upon Thiokol I to hold, as a matter of law, that no case of actual controversy can exist between the parties, the decision should be reversed.

III. Interpretation of the License Agreements Necessitates an Evidentiary Hearing

Allied argues that there was no need for an evidentiary hearing because there was no conflict in the facts before the District Court. [Allied Br. at 34] However, the interpretation and effect of the "favored nations" clauses in the License Agreements were disputed before the District Court. [A-301-03] These clauses, together with a license to a third party [A-102], mean that the non-termination period ended in March of 1976. Furthermore, appellants' counsel contended at oral argument that the purpose of the Settlement Agreement was not to prevent litigation of the validity of the Allied patents for the period prescribed by the non-termination clauses. [A-295]

An evidentiary hearing should have been held on the purpose and interpretation of the non-termination clauses and the "favored nations" clauses and the parties should have been afforded an opportunity for discovery on these issues. Surpitski v. Hughes-Keenan Corp., 362 F.2d 254 (1st Cir. 1966).

Given the disputed issues of fact, even summary enforcement of the Agreements would have necessitated an evidentiary hearing. Autera v. Robinson, 419 F.2d 1197, 1203 (D.C. Cir. 1969); Kukla v. National Distillers Products Co., 483 F.2d 619, 622 (6th Cir. 1973).

IV. The District Court Did Not Have the Power to Order Payment of Royalties

In its argument in support of the order to pay royalties, Allied does not dispute that the District Court could not order payment of royalties if it lacked subject matter jurisdiction over the action. Allied instead takes the position that in the proceeding below the District Court had continuing jurisdiction to summarily enforce the Settlement and License Agreements. However, Allied did not move for summary enforcement in the District Court. Allied has not served an Answer or Counterclaim against Warner-Jenkinson or Kohnstamm, and its motion under Rule 12(b)(1), Fed.R.Civ.P. was limited to seeking dismissal for lack of subject matter jurisdiction. Moreover, as reflected in the record, Judge Frankel did not order specific performance of the Settlement Agreement. [A-268-69] Thus, jurisdictional power to order payment of royalties cannot be predicated upon Allied's _post hoc_ theory that the District Court summarily enforced the private Settlement and License Agreements.

Furthermore, even if the District Court had been requested to summarily enforce the private License Agreements, it could not have done so. As set forth above, the prior settlement is not entitled to _res judicata_ effect. Accordingly, it cannot be used to cut off a defense which Warner-Jenkinson and Kohnstamm are entitled to raise under _Lear_. See _Autera_ v. _Robinson_, 419 F.2d 1197,1200 (D.C. Cir. 1969); _Kukla_ v. _National Distillers Products Co._, 483 F.2d 619 (6th Cir. 1973).

V. The Proposed Escrow Arrangement Is Proper

Allied quotes extensively from Morton-Norwich Products, Inc. v. International Salt Co., 183 U.S.P.Q. 748 (N.D.N.Y. 1974), a suit in which the licensee sought a declaration of invalidity of the licensed patent.* In ruling that the absolute withholding of royalty payments was a breach permitting the licensor to assert a counter- charge of infringement, the Morton-Norwich Court was concerned with encouraging the prompt testing of validity. However, the escrow arrangement which Warner-Jenkinson and Kohnstamm have proposed in the instant litigation is a device which will provide an incentive for both sides to avoid delay in securing a final judgment.

Allied contends that the case law does not support the use of an escrow arrangement by the challenging licensee, but the recent case of Nebraska Engineering Corp. v. Shivvers, Civ. No. 76-222-1 (S.D.Iowa Oct. 1, 1976) (copy attached as Exhibit A) represents yet another example of such an arrangement.

Allied has not contested Warner-Jenkinson and Kohnstamm's assertion that, absent an escrow arrangement, it may be difficult to secure a return of any royalties paid pendente lite. Perhaps Allied's reticence on this point arises from the fact

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* Unmentioned by Allied is the fact that the Morton-Norwich Court did not question its subject matter jurisdiction to entertain an action between a licensor and a licensee seeking a declaration of invalidity of a licensed patent. That Court expressly followed Medtronic, Inc. v. American Optical Co., 327 F.Supp. 1327 (D.Minn. 1971) and expressly declined to follow Thiokol I. 183 U.S.P.Q. at 750 n.9.

that under the License Agreements, Allied reserved the right to assign the patents in suit to a third party. [A-83,96] In the event of an assignment, Warner-Jenkinson and Kohnstamm might well find themselves paying royalties, pendente lite, to a judgment-proof entity.*

* Such a possibility is suggested by a short notice found on page 37, column 1 of the October 29, 1976 issue of The Wall Street Journal (copy attached as Exhibit B). That notice indicates that Allied has agreed to sell its dyestuffs plant (which makes, inter alia, food colors) and "related assets" to one "Buffalo Color Corp." An inquiry to the Office of the New Jersey Secretary of State indicates that while such a corporate name has been reserved no such corporation has yet been registered.

VI. Conclusion

The contentions raised by Allied are without merit; and the final Order and Judgment of the District Court should be reversed.

Respectfully submitted,

KENYON & KENYON REILLY CARR & CHAPIN
Attorneys for Appellants
Warner-Jenkinson Company
H. Kohnstamm & Company, Inc.

Francis T. Carr

Date: Dec. 6, 1976

Francis T. Carr
Paul Lempel
Edwin Baranowski
Philip J. McCabe
Stephen B. Shear
KENYON & KENYON REILLY CARR & CHAPIN
59 Maiden Lane
New York, New York 10038
(212) 425-7200

OF COUNSEL

Donald G. Leavitt
Koenig, Senniger, Powers & Leavitt
611 Olive Street
St. Louis, Missouri 63101
(314) 231-0109
Counsel for Warner-Jenkinson Company

Patrick J. Joyce
1270 Avenue of the Americas
Suite 2102
New York, New York 10020
(212) 247-5810
Counsel for H. Kohnstamm & Company, Inc.

EXHIBIT A

Slip Opinion

Nebraska Engineering Corp. v. Shivvers
Civ. No. 76-221-1 (S.D.Iowa Oct. 1, 1976)

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

FILED

OCT 1 1976

JAMES R. ROSENBAUM
CLERK, U. S. DISTRICT COURT
SOUTHERN DISTRICT OF IOWA

NEBRASKA ENGINEERING CORP., Plaintiff,	)	
vs.	)	CIVIL NO. 76-222-1
CHARLES C. SHIVVERS, Defendant.	)	ORDER

On July 14, 1976, plaintiff Nebraska Engineering Corporation filed the above entitled declaratory judgment action seeking to contest the validity, scope, and enforceability of certain patents underlying a non-exclusive lic .se agreement entered into between plaintiff as licensee and defendant Charles Shivvers as patentee-licensor. The complaint alleges that pursuant to it belief that the patents are invalid and unenforceable, plaintiff has withheld royalties purportedly due under the agreement within sixty (60) days following the end of March, 1976. The complaint further alleges that defendant's attorney, in accordance with § 5.2 of Article 5 of this agreement, has notified plaintiff of the delinquency in transmitting royalty payments and of its presumed intention to terminate the license if payments are not made within thirty (30) days following receipt of such notice by plaintiff. Plaintiff acknowledges receipt of this notice on July 6, 1976. Defendant has agreed, however, not to exercise its termination rights while the instant matter is under consideration by the Court. Plaintiff alleges that it has not repudiated the agreement and does not want its license terminated.

Before the Court at this time is plaintiff's motion, filed July 14, 1976, for a preliminary injunction under Rule 65 F.R. Civ. P. authorizing plaintiff to (a) pay royalties to an escrow agent appointed by the Court during the pendency of the present litigation on the validity, scope, and enforceability of the patents in suit underlying

the license agreement between plaintiff and defendant; and (b) enjoining defendant from terminating the license agreement between plaintiff and defendant pending litigation of the patents in suit. Maintenance of the status quo during a lengthy court contest is the asserted basis for plaintiff's motion. Defendant resisted the motion and the matter came on for oral argument before the Court in chambers on September 2, 1976. For reasons stated below, the Court is of the opinion that an injunction is warranted.

Resolution of this matter focuses on the policy considerations underlying the Supreme Court's decision in Lear, Inc. v. Adkins (1969), 395 U.S. 653. In Lear the Court held that a licensee is not estopped to interpose the invalidity of the licensed patent as a defense to a suit for royalties brought by the licensor. 395 U.S. at 669-71. Citing "overriding federal policies", Lear further refused to require the licensee to pay royalties during the time the validity of the patent is being challenged in the courts notwithstanding a provision in the license agreement there involved that royalties were to be paid until such time the "patent is held * * * invalid". 395 U.S. at 673. To do otherwise, the Court observed, would encourage dilatory tactics by the licensor to postpone the day of final judicial reckoning. Thus, one of the primary goals of the Lear decision has been stated to be the "unmuzzling" of licensees so that an early adjudication of invalidity could inure to the public interest. Atlas Chemical Industries, Inc. v. Moraine Products (6th Cir., 1974), 509 F. 2d 1, 6. As the Lear court stated:

> Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain. Licensees may be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would-be monopolists without need or justification. We think it plain the technical requirements of contract doctrine must give way before the demands of the public interest in the typical situation involving the negotiation of a license after a patent has issued.

395 U.S. at 670-71.

In Crane Co. v. Aeroquip Corp. (N.D. Ill., 1973), 356 F. Supp. 733, plaintiff licensor brought actions against the licensee for breach of contract and patent infringement. On a motion for partial summary judgment to adjudicate the license agreement terminated due to certain acts and omissions of the defendant, the Court held that as a matter of contract law the plaintiff's arguments were persuasive, but the policies announced in Lear precluded granting the motion:

> Although the facts and issues in Lear required the court to go no further than to hold that the doctrine of licensee estoppel would no longer be a defense available to licensors and that a licensee would be able to challenge the validity of the patent without having to continue paying royalties or, in effect, having the license contract strictly enforced against it during the pendency of the litigation, the rationale of Lear must surely extend to the converse situation raised in this case. Instead of being asked to enforce the contract, even though the licensee has raised the validity defense, Crane has asked this court to adjudicate the license as terminated essentially because the licensee has raised the validity defense. Yet, just as the imposition of the doctrine of licensee estoppel would have a chilling effect on meritorious challenges to pa ents, as well as ultimate competition with the liensee, so would the threat of termination of the license have a similar effect. (Emphasis original) 356 F. Supp. at 738-39.

Th issuance of a preliminary injunction is generally within the sound judicial discretion of the Court. Robinswood Community Club v. Volpe (9th Cir., 1974), 506 F. 2d 1336. The Court is satisfied that granting of an injunction in this case will effectuate the prime public interest policy of Lear to encourage early and prompt determinations of patent validity and to eliminate obstacles to suit by those disposed to make validity challenges. As the Crane case recognized, the threat of license termination is substantially equivalent in its chilling effect of meritorious patent challenges to the imposition of the doctrine of licensee estoppel overturned by Lear.

In the recent case of Milton Roy Company, et al. v. Bausch & Lomb, Inc., et al., filed August 9, 1976, the United States District Court for the District of Delaware refused to require royalty payments

into escrow and refused to enjoin the cancellation of the licensing agreement for non-payment of royalties pending the determination of the validity of a patent. The Court stated that the licensee is fully protected insofar as the federal policy is concerned by his ability to choose between (1) making royalty payments with the right to sue to recover them if invalidity is declared, and (2) refusing to make payments and depend upon state contract law to determine whether non-payment subjects the license to termination by the licensor.

The Court is not persuaded that such options are adequate under these facts, to protect the status quo of the parties and promote the public interest in an early determination of patent validity. This is a non-exclusive license. The licensor would not be substantially harmed by an injunction which prohibits cancellation of a non-exclusive license. Licensee has a large capital investment in a plant where the licensed product is manufactured. As it cannot take a chance on the termination of its going business, the choice is more illusory than real. It's only real option would be to pay the royalties and seek to recover them upon a declaration of invalidity, hoping defendant would remain solvent. Public interest in an early determination would appear to be best served by the appointment of an escrowee to collect, hold and invest royalty payments due under the contract until the validity of the patent has been determined and then to pay the accumulated fund to the prevailing party. Neither party should be interested in delaying tactics as the fund will not be accessible to either until the action is determined on the merits.

As plaintiff took no affirmative steps to assert the invalidity of the patent until July 2, 1976, the Court believes that all royalty payments due Shivvers prior thereto should be paid directly to the defendant. PPG Industries, Inc. v. Westwood Chemical, Inc. (6th Cir., 1976), 530 F. 2d 700.

IT IS THEREFORE ORDERED that parties shall attempt to agree upon an escrow agent (Escrowee). If parties have not designated an Escrowee within 10 days from the date of the filing of this Order, the Court will designate an approved federal depository to act as escrow agent. Plaintiff is Ordered to pay all royalty payments due or to become due to the defendant under the terms of the license agreement from and after July 2, 1976 to such Escrowee. The Escrowee shall hold and invest the royalty payments in certificates of deposits or United States government bonds, in its discretion. After a decision on the invalidity of the pertinent patents has become final, the Escrowee shall deduct its fees from the fund and pay the balance over to the prevailing party.

IT IS FURTHER ORDERED that defendant should be and he is hereby enjoined from terminating the License Agreement herein involved during the period of time the royalty payments are paid to the Escrowee under the terms of the foregoing paragraph; provided however that this injunction shall become null and void if plaintiff does not pay to defendant any and all royalties due under the terms of the contract up to and including July 1, 1976, within 10 days after the filing of this Order.

Signed this 1 day of October, 1976.

W. C. Stuart
W. C. Stuart, U.S. District Judge
Southern District of Iowa

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EXHIBIT B

News Notice

The Wall Street Journal
Oct. 29, 1976 at 37, col. 1

Allied Chemical to Sell Buffalo, N.Y., Facility

By a WALL STREET JOURNAL *Staff Reporter*

MORRISTOWN, N.J. — Allied Chemical Corp. said it agreed to sell its Buffalo, N.Y., dyestuffs plant and related assets. The company declined to disclose the proposed terms.

The buyer would be Buffalo Color Corp., a newly formed joint unit of Top-Tex Inc., Summit, N.J., and Wm. Sword & Co., Princeton, N.J.

The Allied plant's main product is indigo dye used for blue denim. It also makes other textile dyes, food colors and other products. The plant has about 600 employes, including related sales and administrative employes.

Allied cited its "long-term strategy to redeploy our assets to maximize profits."

I, Philip J. McCabe, hereby certify that on this 6th day of December, 1976, I caused three copies of the Reply Brief for Plaintiffs-Appellants to be served by hand on Dick E. Reeve, counsel for appellee.

Philip J. McCabe